

12 May 2014

Australian Energy Market Commission,
Level 6, 201 Elizabeth Street,
Sydney, NSW, 2000

Executive Summary

Westpac supports the proposed rule change to require generators to bid and rebid in good faith. Westpac believes this is a core pillar of an efficient market in which price accurately reflects the balance of supply and demand at any given time. However, we do not agree that the generators should be restricted to rebidding in response to AEMO data alone.

About Westpac

Westpac is the largest and oldest financial intermediary in the electricity wholesale market. Westpac is a key market maker in the SFE and OTC markets, a credit provider to junior retailers and wholesale electricity providers and a significant participant in the Settlement Residue Auction. Westpac Institutional Bank is also a significant lender to the electricity sector.

In its role as a liquidity provider for market participants, Westpac transacts a significant percentage of the SFE and OTC market volume and must also be comfortable to carry residual risk through to spot when necessary.

Accordingly, in order for Westpac to effectively provide the liquidity, risk reduction and credit services to the electricity market that it does, it is essential that the spot market is operated in a highly transparent and economically efficient manner.

Westpac can offer a unique perspective on the issue of good faith rebidding. As an active trading participant in the wholesale derivative market, we pay close attention to the real time operation of the spot market, including the behaviour of physical market participants, without having a physical position ourselves.

National Energy Objective

The proposed rule change, with the exception of the requirement to only rebid in response to AEMO data, would further the National Energy Objective, being:

"to promote efficient investment in, and efficient operation and use of, electricity services for the long term interests of consumers of electricity with respect to –

- (a) price, quality, safety, reliability and security of supply of electricity; and
- (b) the reliability, safety and security of the national electricity system"

Rebidding only in good faith would allow for more efficient operation of the generation fleet and would assist to ensure prices in the market more accurately reflect the balance between supply and demand. In turn, efficient, information-rich prices allow for efficient investment.

Quality, safety, reliability, and security would not be affected by the proposed rule change as generators remain free to rebid for genuine technical reasons.

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Consultation Items

Question 1: Do you consider late strategic rebidding to be the primary issue raised by this rule change request?

Yes. There are mostly two types of late rebidding.

- 1) Rebids often occur as late as possible to limit competitor's response times and to make use of the 5min/30min settlement issues as discussed further in response to Question 2.
- 2) Late rebidding can also reduce the time available for peaking generators to purchase or schedule gas to meet generation needs or purchase or sell hedge cover from the futures market.

We agree that transient pricing power is a necessary feature of the NEM and also agree that transient pricing power should arise in genuinely tight supply/demand conditions, rather than artificially created periods of tightness.

Question 2: Do you consider the NEM trading arrangements of five-minute dispatch and 30-minute settlement to be relevant to the issue of late strategic rebidding? Do you have any views as to how any issues arising could be addressed?

We agree with the AEMC's assessment of the incentives created by the mismatch between 5-min dispatch and 30-min settlement.

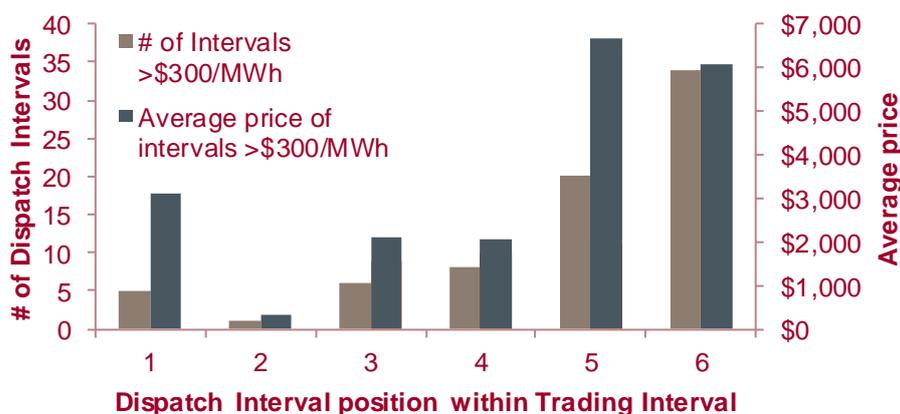
Specifically, and statistically demonstrably, the situation usually arises when a region's interconnectors are limited and a participant with a portfolio of generators in the region makes a sharp cut to their cheap capacity across most of the generation units with a rebid in the final 5 or 10 minutes of a 30 minute trading interval. This causes a 5 min price jump.

Fast-start generators will be dispatched in response to the higher 5 min price, but will only be paid the average price over the last 30min, with can be almost 6 times lower than the 5min price that was bid in good faith.

Participants with a defensive market position may choose to run their generators with plentiful spare ramp capacity at a cheap price to counter the strategy of cutting cheap capacity. However, this defensive strategy requires running peaking units at minimum load in anticipation of rebidding behaviour by other market participants. In the absence of an expectation of rebid-driven price spikes, these peaking units would not choose to run. As peaking units typically have a high fuel cost, this results in a reduction in market efficiency as well as a wealth transfer.

Finally, peaking generators may have significant start-up costs that are independent of the MWh produced. Rebidding behaviour that forces defensive fast-start units to continually stop and start in response to the rebidding behaviour also creates a reduction in overall market efficiency. In the

Dispatch spike distribution QLD 2014 to date



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absence of strategic rebidding, the fast start units would only need to start once and then run continuously to cover the highest demand periods. To counteract this, fast start units bid their capacity in at a higher price than they would if they were confident of being dispatched for at least a trading interval.

There were 74 fine-minute dispatch intervals greater than \$300/MWh in QLD since the start of the year. Only 8 of those dispatch intervals sequentially followed a previous dispatch interval that was also above \$300/MWh. The bulk of the dispatch intervals above \$300/MWh occurred in the last 10 minutes of the half hour, and were more expensive than price spikes in earlier trading intervals

We agree that the 5min volatility created by opportunistic rebidding behaviour has created an increase in the risk premium of hedge contracts and forms a significant part of how we assess the value of electricity derivatives, particularly in QLD. It is important to note that rebidding strategies can often be executed at moderate demand levels, creating a disconnect between price and economic fundamentals.

Question 3: Do you consider there to be benefits in the proposed rule to reverse the onus of proof onto generators?

Reversing the onus of proof is the core component of this rule change request. As outlined in the discussion paper, the AER will rarely have access to all the evidence needed to prove that a rebid was made without good faith. Additionally, market participants are better resourced than the AER to interpret or explain motive from changes in bidding behaviour.

By contrast, if a generator makes a good faith rebid it would be in response to new information such as a change in demand, contracting, fuel position, technical failures or weather data. Such information would be delivered electronically in most cases and automatically stored, allowing recall in the event that good faith must be proven.

Question 4: (a) Do you consider that all known conditions and circumstances should be taken into account in generator bids and rebids?

Yes. If generators are able to significantly delay response to new information, then opportunistic late rebidding would still be possible.

(b) Do you consider the proposed rule to be practical and sufficiently clear as to when a generator must rebid following a change in material conditions and circumstances?

Companies that have experience operating power stations should answer this question. However, given the financial incentives, we would be surprised if it took traders longer than a few five-minute trading intervals to digest new information.

(c) Do you consider that rebids should only be limited to the occurrence of a significant change in conditions and circumstances? If so, how would this be achieved in practice?

Yes. Rebids currently mention trivial changes in demand, price, and interconnect constraints that have no real relevance to the generating unit or their portfolio. A materiality condition must be applied to new information. New information from AEMO comes every 5 minutes, but is not often 'material'.

Question 5: Do you consider it reasonable that all bids and rebids should be made with reference to published AEMO data?

No. Data that would be highly material to generators that is not published by AEMO includes temperature data, weather forecasts and gas positions both financial and physical. Generators may also occasionally execute large hedge contract trades which require a change in strategy in the spot market. Generators may also make short term trades in the contract market.

Limiting generators ability to respond only to AEMO data would decrease market efficiency.

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Allowing third-party data to be used as a reason for a rebid would not affect the implementation of this rule. The burden of proof would still lie with the generators to show that the change in third-party data was material.

Question 6: (a) ... Do you consider any... other options around the design of the bidding process to better address the issues raised in the rule change request?

We agree with the ACCC's reasons for rejecting the three alternative proposals outlined in the discussion paper.

Disallowing rebidding within three trading intervals prior to dispatch would not allow for prompt responses to changes in demand. On the first morning of the heat wave that hit Melbourne and SA this summer, forecasts were constantly being materially updated as demand significantly outstripped forecast demand. An inability to rebid units could have led to delays in commitment of peaking generation.

Disallowing only rebids that increase the spot price is unlikely to work either. It may help stop issues associated with the 5min dispatch vs 30 min settlement mismatch, however, generators would still be able to restrict cheap capacity in predispatch, causing the predispatch price to look expensive and then later rebid to a cheaper price after selling hedge contracts or spot gas.

Allowing rebidding only for genuine technical reasons would incentivise generators to overstate the importance of technical issues. Many generators are owned by retailers and there can be significant uncertainty in the volume required by their customers in any given period. Rebidding is a genuine market response to changes in contract or physical position.

Conclusion

Westpac supports the rule change request to require generators to bid and rebid in good faith, principally as it ensures that the spot price outcomes accurately reflect the balance of supply and demand in the market – an essential component of an efficient market and a necessary pre-condition for intermediaries such as Westpac being able to continue to provide the liquidity and risk reduction services desired by market participants.

However, we do not agree that the generators should be restricted to only rebidding in response to AEMO data.

Feel free to contact us for further information.

Yours Sincerely,

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